



Billing Code 4210-67

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

[Docket No. FR-5728-N-02]

Federal Housing Administration (FHA):

Small Building Risk Sharing Initiative Final Notice

AGENCY: Office of the Assistant Secretary for Housing - Federal Housing Commissioner, HUD.

ACTION: Notice

SUMMARY: This Final Notice announces HUD's implementation of an Initiative under the Risk Sharing Program (the "Initiative"), authorized by Section 542(b) of the Housing and Community Development Act of 1992, to facilitate the financing of small multifamily properties. Through this Final Notice, HUD invites applications for the Initiative described in this Notice from high capacity Community Development Finance Institutions (CDFIs), other non-profit lenders, and public and quasi-public agencies (collectively referred to as Mission Based Lenders), and private, for-profit lenders approved as FHA Multifamily Accelerated Processing (MAP) lenders (referred to as Private Lenders), to participate in HUD's Risk Sharing Program as Qualified Participating Entities (QPEs).

DATES: Effective Date of Initiative **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

Application Date for Mission Based Lenders: Applications will be completed in a two-stage process: Pre-Qualification and Final Application. Pre-Qualification Applications from Mission Based Lenders will be accepted starting on the effective date of this Notice. If the Pre-Qualification Application is approved by HUD the applicant will have 90 days from receipt of HUD's approval to

complete its FHA Lender application online and deliver a Final Application to HUD.

Application Date for Private Lenders: Applications will be completed in a two-stage process: Pre-Qualification and Final Application. Pre-Qualification Applications from Private Lenders will be accepted starting six (6) months from the effective date of this Notice. If the Pre-Qualification Application is approved by HUD the applicant will have 90 days from receipt of HUD's approval to deliver a complete Final Application to HUD. (Note Private Lenders must be FHA MAP Lenders in good standing in order to apply; therefore separate FHA Lender applications are not required.)

ADDRESSES: Interested parties are invited to submit applications including information outlined below, within the time frames described above.

FOR FURTHER INFORMATION CONTACT: Diana Talios, Office of Multifamily Housing Programs, Office of Production, Department of Housing and Urban Development, 451 7th Street SW, Room 6148, Washington, DC, 20410; email address Diana.J.Talios@HUD.gov and telephone number (202) 402-7125 (this is not a toll-free number). Persons with hearing or speech impairments may access this number through TTY by calling the toll-free Federal Relay Service at 800-877-8339.

SUPPLEMENTARY INFORMATION

I. INTRODUCTION

A. Purpose

Under the Initiative, applicants qualified as QPEs will rely on a 50 percent risk sharing arrangement with HUD to underwrite, originate, and service loans that (1) are secured with properties of 5 or more rental dwelling units, and (2) do not exceed the amount of \$3,000,000, or, in the case of projects located in "High Cost Areas" annually designated by HUD, (most recently in

Mortgagee Letter 2014-14¹), the amount of \$5,000,000.

B. Proposed Statutory Changes

HUD intends to pursue statutory changes to Section 542(b) of the Housing and Community Development Act of 1992 that would, through loans originated by lenders that have demonstrated experience in affordable housing lending, remove affordability restrictions currently required under Section 542(b). The change is intended to reduce the burden on owners who access this capital in order to provide affordable housing in their communities. The language would also authorize Ginnie Mae to securitize loans on small buildings made under Section 542(b), which could significantly enhance the impact and utility of the Initiative. If granted this authority by the Congress, HUD would invite applicants that participate under the authority of this Final Notice to modify their agreements to take advantage of such new authority. Until such statutory changes are made, lenders participating in this Initiative may have access to low-cost long-term financing through the Federal Financing Bank (FFB). The FFB Risk Sharing Initiative announced June 26, 2014, now provides capital for multifamily loans insured under Section 542 (c) of the Risk Sharing Program. HUD and the Treasury Department are currently formalizing an agreement to expand this capital source to lenders participating in the Small Buildings Initiative. Additional application criteria and program standards may be required by HUD and the Treasury Department in order to qualify for FFB financing under this Initiative.

C. Initiative Description

Lenders approved to participate in the Initiative will be authorized to originate, underwrite, and service loans for HUD multifamily mortgage insurance for project acquisition, refinancing, rehabilitation (up to and including substantial rehabilitation) and/or equity take outs, but excluding

¹ See <http://portal.hud.gov/hudportal/documents/huddoc?id=14-14ml.pdf>.

new construction. The amount of the equity take-out, or “cash out”, cannot exceed the scope of work that is paid for by the Risk Sharing loan proceeds. Further, the rehabilitation must address all of the capital needs in the Capital Needs Assessment (CNA) and satisfy the reserve requirements for the life of the loan. The cornerstone of the Risk Sharing Program is that the lender shares the insurance risk with FHA. Since lenders will cover 50 percent of the risk of loss under this Initiative, FHA offers participants significantly more flexibility with respect to underwriting terms, and ongoing compliance than is found in Risk Sharing Program elements with higher risk allocations to FHA, and in other FHA Multifamily insurance programs.

Upon presentation of appropriate project information and certifications, HUD will endorse such loans for full mortgage insurance. QPEs will be responsible for the full range of loan management, servicing, and property disposition activities.

Through a Risk Sharing Agreement (RSA) QPEs will contract to assume 50 percent of the risk on each loan they underwrite. In turn, upon a default, HUD will commit to pay an initial claim amount based on 100 percent of the unpaid principal balance of an insured mortgage note plus interest at the mortgage note rate from the date of default to the date of an initial claim payment upon default of the loan and filing of a claim. The loss, if any, will be determined at a later date and HUD and the QPE will share such loss in accordance with the fifty-fifty share of risk assumed by each under the RSA.

D. Contents

This document contains information on applicant eligibility, application requirements, application process, the timeframe for decisions on applications, and other program features and requirements.

II. BACKGROUND

HUD's 2012 Rental Housing Finance Survey (RHFS) data indicates there are approximately 495,574 small (5-49 units) multifamily rental properties in the United States, constituting more than a quarter of rental units across the nation (2012 Rental Housing Finance Survey). Small multifamily properties tend to be older, located in low-income neighborhoods, and to have lower median rents and higher shares of affordable units than larger multifamily rental properties. The 2012 RHFS also suggests that 87 percent of the owners of this stock are individuals, households and estates, compared to 8 percent of larger properties with 50 or more units. Similarly, according to the RHFS, just 52 percent of small multifamily properties are mortgaged compared to 87 percent of the larger multifamily properties.

Worst case housing needs are defined as renters with very low incomes (below half the median in their area) who do not receive government housing assistance and who either paid more than half their monthly income for rent, lived in severely substandard conditions, or both. Worst case housing needs were 7.7 million in 2013, down from a historic high of 8.5 million in 2011, ending a sustained period of large increases. This represents a 9 percent decline since 2011 yet remains 9 percent greater than in 2009 and 49 percent greater than 2003. Worst case needs affect very low-income renters across racial and ethnic groups, and all types of households.²

Long-term fixed rate mortgages made through this Initiative will be especially valuable because smaller properties tend to command modest rents and owners are often unable to raise rents to cover upward interest rate adjustments without causing vacancies. Additionally, the “mom and pop” ownership of this inventory faces more constraints in accessing financing in recent years due to increasingly high credit standards and diminished lending, following a significant loss of many community and regional banks in the wake of the 2008 recession.

² See http://www.huduser.org/portal/Publications/pdf/WorstCase2015_summary.pdf

HUD has chosen to include both Mission Based Lenders (defined to include CDFIs, other nonprofits and quasi-public and public agency lenders) as well as for-profit, private lenders (Private Lenders). Mission Based Lenders will be eligible for the first application round, beginning on the effective date of this Final Notice, while Private Lenders may apply 6 months later. Although the Initial Notice allowed for the admission of consortia or joint ventures comprised of Private Lenders under the control of a Mission Based Lender, HUD determined this would complicate program operations and introduce unnecessary complexity into the program. However, a newly formed organization could be created. The new entity will have to meet all the requirements of this Final Notice including qualifying as an approved FHA non-supervised mortgagee.

The Initiative implemented by this Final Notice is intended to encourage eligible Mission Based and Private Lenders to move into this market or to serve it more fully with an additional source of capital. One common problem facing non-depository CDFIs and other Mission Based Lenders is access to long-term capital, which may limit their ability to provide housing finance to their communities. These organizations can qualify as QPEs by demonstrating that they meet minimum criteria including designation as non-profit entities or as public or quasi-public benefit corporations under the laws of their States of formation, and exemption from Federal income taxation pursuant to the Internal Revenue Code of 1986. These Mission Based Lenders, as well as Private Lenders, must demonstrate that they meet various financial standards, and that a minimum amount of their recent loan activity has been dedicated to the financing of affordable housing.

III. AUTHORITY

Section 542(b) of the Housing and Community Development Act of 1992, as amended by Section 307 of the Multifamily Housing Property Disposition Reform Act of 1994, authorizes HUD to enter into RSAs with QPEs. QPE is broadly defined in Section 542(b) to allow HUD to enter

into agreements with a range of lenders. Following full consideration of the comments submitted in response to the Initial Notice, HUD is hereby issuing this Final Notice to provide details of the implementation of the Initiative along with descriptions of changes made to the Initiative in response to public comment and/or further consideration of HUD as to how the Initiative should be structured or implemented.

IV. KEY CHANGES MADE TO INITIAL NOTICE

HUD announced a request for comments through a notice published in the Federal Register on November 4, 2013, at 78 FR 66043, which solicited public comment for a period of 60 days. The November 4, 2013, notice is referred to as the “Initial Notice.”

The following highlights key changes made to the Initial Notice. HUD received 41 public comments from approximately 28 different sources of interest. Respondents included CDFIs and FHA/MAP lenders, but the most prominent respondent group was comprised of nonprofit organizations, mainly membership organizations engaged in affordable housing preservation activities. All public comments may be viewed in their entirety online under docket number FR-5728-N-01 at <http://www.regulations.gov/#!docketDetail;D=HUD-2013-0102>. Also posted on HUD’s Multifamily Web site at http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/mfh/progdesc/progsec542b is a summary of the public comments and HUD’s responses to the comments received to the Initial Notice.

A. General Comments

Virtually all commenters recognized a pervasive need for programs to deliver capital to small scale lenders, and to promote the preservation of unassisted, affordable, small rental buildings, and they were largely supportive of the Initiative concept and program purposes as described by

HUD in the Initial Notice. Some specifically supported the use of HUD's Risk Sharing Program for this purpose as well. Comments made with respect to inclusion of coop housing were consistently positive. Virtually all of the commenters that mentioned HUD's parallel legislative efforts to enhance the program (described in Section I.B. of this Final Notice) were supportive of them.

Although largely supportive of the Initiative, commenters recommended modifications to virtually all elements of the design of the proposed Initiative. Their recommendations addressed the types of lenders and consortia allowed to participate, the standards with which participating lenders should be selected, and the borrowers' ongoing financial and reporting requirements. Even the most fundamental parameters of the Risk Sharing Program drew comments. These included the affordability requirements, loan standards, loan application requirements, and various federal review requirements such as environmental reviews, etc. In some cases recommendations were contradictory, for example some recommended more restrictive affordability requirements while others recommended less restrictive requirements. This section summarizes the key changes made by HUD to the Initial Notice. Complete application requirements and program details can be found at http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/mfh/progdesc/progsec542b. Specific Changes are highlighted below.

1. Lender Eligibility: Expansion of lender eligibility to invite FHA MAP lenders to participate. Their participation will be deferred by 6 months from the initiation of the program, so that CDFIs and other nonprofit, public, or quasi-public organizations can start first and provide HUD with an opportunity to fine tune the program before having to manage larger numbers of participants.
2. Applicant/Lender Qualification Requirements
 - a. Demonstrable experience in affordable housing finance: applicants are required to provide recent experience in lending for the production and/or preservation of "affordable

housing” which for this purpose meets the minimum requirements of the Risk Sharing Program. During the past 2 years, no less than 20 percent or 20 of the applicant’s multifamily housing loans originated, must have been made for affordable housing as their primary purpose. The Initial Notice required 33 percent of the applicant’s loans over the past 2 years or 33 percent of dollars loaned to be dedicated to affordable housing purposes.

b. Financial Capacity: Minimum financial capacity requirements were added since the Initial Notice. Applicants must either have a 20 percent net asset ratio and a minimum net worth of \$7.5 million, or a CAMELS composite rating of 1 or 2 under the Uniform Financial Institutions Rating System (UFIRS)³ or equivalent nationally recognized rating system, and a minimum net worth of \$7.5 million. No additional reserves are required so long as this standard is maintained. If the QPE can no longer meet this standard, a dedicated reserve must be established in a financial institution acceptable to HUD.

c. Lender Staff Experience: The Initial Notice required lender’s staff to demonstrate 3 years of originating FHA insured loans. This requirement was changed to permit alternative multifamily housing finance experience so long as it is substantial and fully described in the application.

d. Lender’s Net Income: Applicants will demonstrate financial solvency by disclosing annual income, as well as expenses and net income for each of the past 5 calendar years, and provide a computation of positive net income from the best 3 of those 5 years.

e. Lender Staff Capacity: Applicants must demonstrate experience with multifamily housing mortgage servicing, and asset management, provide written procedures for work-outs, and describe management responsibilities.

³ See <http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/bsp-2.PDF>

- f. **Certification of Compliance with Fair Housing and Civil Rights Requirements:** An applicant must certify that it is not subject of a suit filed by the Department of Justice or has an outstanding finding of noncompliance with a civil rights statute.
3. **Eligible Projects and Loan Size Limits:** Projects must consist of 5 or more rental dwelling units (including cooperative dwelling units) on one site. Scattered sites can be considered so long as each site has a minimum of 5 units, and can demonstrate it is one marketable and manageable real estate asset. Loan amounts have been increased from \$3 million to \$5 million in certain high cost areas. Areas will be designated in HUD's "Annual Base City High Cost Areas" Mortgagee Letter. In the Initial Notice, eligible projects consisted of either 5-49 units, or if the project consisted of more than 49 units, the loan amount could not exceed \$3,000,000.
4. **Building Owner Requirements:** Audited financial statement requirements may be waived by the QPE when it can be justified by the nature of the project and that the borrower has sufficient capacity to successfully manage the property.
5. **Loan Terms:** Loan terms are changed to allow for balloon payments at the end of year 15 or thereafter, with an amortization term of no more than 30 years. Alternatively, loans may fully amortize over a term of up to 40 years.

V. HUD'S DECISIONS ON APPLICATIONS

HUD will act on Pre-Qualification submissions based on the criteria provided in the Application Requirements posted on the Web at http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/mfh/progdesc/progsec542b, within approximately 30 days of the date HUD deems the application to be complete, either by denying the request or by inviting the applicant to submit a Final Application. HUD will act on Final Applications within approximately 60 days from the date of receipt of the Final Application.

This will include notifying applicants determined to be eligible as QPEs, and delivering a RSA. It is important to note that Mission Based Lenders must be approved as FHA Non-supervised Mortgagees in advance of their approval as a QPE. An FHA Lender Approval Application, Form 92001-A, can be downloaded from HUD's website at:

<http://portal.hud.gov/hudportal/documents/huddoc?id=92001-a.pdf>.

VI. EVALUATION OF THE INITIATIVE

One of the principal purposes of the Initiative is to determine whether, by providing Federal credit enhancement for refinancing and rehabilitation of small multifamily housing, the Initiative is successful in increasing the flow of credit to small multifamily properties. HUD will, therefore, undertake an evaluation of the Initiative to determine the success of the Initiative and will expect participation by selected lenders.

VII. FINDINGS AND CERTIFICATIONS

A. Paperwork Reduction Act

The information collection requirements contained in this document have been approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520) and assigned OMB control number 2502-0500 and 2502-0541. In accordance with the Paperwork Reduction Act, HUD may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a currently valid OMB control number.

B. Environmental Impact

A Finding of No Significant Impact (FONSI) with respect to the environment has been made for this notice in accordance with HUD regulations at 24 CFR part 50, which implement Section 102(2)(C) of the National Environmental Policy Act of 1969 (42 U.S.C. 4332(2)(C)). The

FONSI is available for public inspection between 8 a.m. and 5 p.m. weekdays in the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 4517th Street SW, Room 10276, Washington DC 20410-0500. Due to security measures at this HUD Headquarters Building, an advance appointment to review the FONSI must be scheduled by calling the Regulations Division at 202-708-3055 (not a toll free number).

Dated: June 30, 2015.

Edward L. Golding, Principal Deputy Assistant Secretary
for Housing.

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